IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX REFERENCE NO. 38 OF 1989.

M/s Jayant Vegolis & Chemicals
P.Ltd. ... Applicant.

V/s.

The Commissioner of Income-tax
Bombay City-V, Bombay ... Respondent.

Shri J.J. Jain i/b Jay Legal Consultant for the applicant.

Shri A.N.Kotangale i/b D.A. Dubey i/b K. C.Sidhwa for the respondent.

CORAM : V.C.DAGA AND A.S.AGUIAR, JJ.

DATED : 25.7.2005

P.C. :
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1. This reference, under section 256(1) of the Income-tax Act, 1961 ('the Act') is made by the Income Tax Appellate Tribunal, ('the Tribunal'); at the instance of the assessee; arising out of its order dated 18.12.1983; for the assessment year 1980-81.

FACTS:

2. The assessee is a private limited company, a proprietor of M/s Jayant Mills Pvt.Ltd. During the assessment year under consideration, the assessee had obtained two import licences to import PVC Resin. For this purpose, it had entered into two

contracts with M/s Palmax Enterprises, Singapore.

3. The first contract was for import of 150 M.T. of PVC resin. This contract was entered into through M/s Jayant Oil Mills Pvt.Ltd which acted as an agent of the assessee.

4. M/s Jayant Oil Mills Pvt. Ltd. as an agent of the assessee, opened a Letter of Credit with the Andhra Bank Ltd., so as to import PVC Resins. The corresponding bank of the Andhra Bank in Singapore was the United Commercial Bank.

5. So far as other import contract, to import of 425 M.T. of PVC Resin is concerned, Letter of Credit was opened through Union Bank of India. Their corresponding bankers in Singapore were Lee Wah Bank, Singapore.

6. It appears that the assessee was informed that the two consignments of PVC resin were put on board s.s."Oh Dai" at Singapore. However, during voyage ship carrying above consignments sank and goods were irretrievably lost.

7. The consignor, M/s Palmax Enterprises demanded payments from the corresponding bankers; namely, United Commercial Bank, and the Lee Wah

Bank, Singapore. The former made payments to M/s Palmax Enterprises sometime in October, 1979. However, no such payments were made by Lee Wah Bank, Singapore though demand in this behalf was raised against the assessee.

8. The assessee, in the return of its income for the assessment year 1980-81 claimed deductions on account of above liabilities arising from two letters of credit opened for importing goods against two contracts valued at Rs.28,39,093/- and Rs.9,75,875/- respectively. As already indicated, former related to the L/C opened to import of 425 M.T. of PVC resin; whereas latter related to the import of 150 M.T. of PVC resin. No payments were made by the assessee either to Andhra Bank or to the United Commercial Bank.

9. The I.T.O. while assessing return disallowed the claim of the assessee. The matter was carried in appeal before the C.I.T.(Appeals) who was pleased to affirm the order of the I.T.O. In second appeal, the Tribunal also affirmed the order of both the authorities below.

10. The Tribunal at the instance of the assessee, by this reference under section 256(1) of the Income-tax Act, has referred the following

questions for the opinion of this Court:-

1. Whether, on the facts and in the circumstances of the case, the Tribunal has erred in law in holding that no liability of Rs. 38,64,968/- has accrued to the assessee under a letter of credit opened by the assessee?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the assessee's liability under the letter of credit was not absolute on the date of the shipment of the goods?

Chamber Summons:

. Before noticing the rival contentions, it would be necessary to dispose of Chamber Summons No. 949/2005 moved by the assessee.

11. The factual matrix giving rise to the Chamber Summons is that the sum of Rs. 38,64,968/- mentioned in the above questions represents the amount of two L/Cs; one opened with Union Bank of India for Rs. 28,89,093/-; whereas another (L/C) for Rs. 9,75,876/- opened with Andhra Bank.

12. The Union Bank of India relieved the assessee from its obligation to pay Rs.28,89,093/- arising from L/C opened with them. Since the Union Bank of India had relieved the assessee from its liability to pay Rs.28,89,093/- the assessee had offered the said amount for tax in the assessment

year 1982-83 under section 41(1) of the Act. In turn, the assessee had applied to the department to exclude the sum of Rs. 28,89,093/- from assessment year 1982-83 in view of remission of this liability; otherwise, it would amount to double taxation. This issue was taken up by the assessee before the Tribunal in a pending appeal arising out of the assessment meant for the assessment year 1983-84. Ultimately, Revenue was directed by the Tribunal to exclude Rs.28,89,093/- from the income of the assessee for the assessment year 1983-84. In the light of this according to the assessee, the claim of Rs. 28,89,093/- has become academic as such assessee has moved this Court with Chamber Summons with a prayer to reduce the figure of Rs. 38,64,968/- by Rs. 28,89,093/- without prejudice to its right to press its claim with respect to the demand standing against it arising out of L/C for Rs. 9,75,876/- issued by the Andhra Bank.

13. Shri Kontagale, learned Counsel appearing for the Revenue submitted that it may be allowed at the risk of the applicant-assessee. Consequently, Chamber Summons is made absolute at the risk of the applicant. As a consequence, the figure of Rs. 38,64,968/- stands substituted with that of Rs.9,75,875/- at the risk of the applicant. Thus, now the claim involved in the reference stands

restricted to Rs. 9,75,875/-. The modified questions shall be as under:

1. Whether, on the facts and in the circumstances of the case, the Tribunal has erred in law in holding that no liability of Rs. 9,75,968/- has accrued to the assessee under a letter of credit opened by the assessee?

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the assessee's liability under the letter of credit was not absolute on the date of the shipment of the goods?

Arguments:

14. Learned Counsel appearing for the Assessee submits that Assessee is following mercantile system of accounting. According to him, liability is deductible, if there exists an enforceable claim against the assessee. The assessee, submits that in the transaction of L/C, the moment the seller submits the documents in conformity with the L/C to the bank with whom L/C was opened, it gives rise to an enforceable claim and bank is obliged to honour the L/C and in turn, entitle to raise a demand on its customer on whose behalf the Letter of Credit was opened. The bank is always under legal obligation to make payment since L/C is nothing but a guarantee on behalf of its customers to pay. This is in accordance with the uniform custom and

practice governing the banking transaction with respect to Letter of Credit.

15. Learned Counsel for the assessee relying on the finding given by the Tribunal that documents have been tendered to the Bank in accordance with the L/C and the corresponding bank having made the payment to the seller, submits that liability has been incurred by the assessee under a L/C which was opened with Andhra Bank and, therefore, the assessee was entitled to claim deduction. He further submits that if subsequently, assessee is relieved of its legal obligation to pay by the bank or by the competent Court (since dispute is pending in DRT) then amount can be brought to tax under section 41(1) of the Act. In this view of the matter, learned Counsel for the applicant submits that the question referred needs to be answered in favour of the assessee.

16. Per Contra, Shri Kotangale, learned Counsel appearing for the Revenue submits that unless actual payment is made the deduction cannot be allowed. He further submits that in spite of lapse of more than 14 years amount has not been paid by the assessee and, therefore, the Tribunal was justified in disallowing the amount claimed by the assessee. He thus submits that question referred needs to be

answered in favour of the Revenue.

Consideration:

17. Having heard the rival parties, it is not in dispute that corresponding bank i.e. United Commercial Bank, Singapore, having paid the amount is pressing for reimbursement of the amount through Andhra Bank. In turn, Andhra Bank is pressing for their claim against the agent of the assessee and insisting for recovery of the amount. In this view of the matter, undoubtedly, assessee has incurred liability to pay. This is not a case of contingent liability. Here assessee has incurred liability through its agent. Merely because in case of one L/C banker did not press for payment liability does not mean that there was and is no liability in respect of another L/C, demand against which standing against the assessee.

18. In the case of Calcutta Co.Ltd. v. CIT (1959) 37 ITR 1(SC), the assessee bought lands and sold them in plots fit for building purposes undertaking to develop them by laying out roads, providing a drainage system and installing lights, etc. When the plots were sold the purchaser paid only a portion of the purchase price and undertook to pay the balance instalments. The assessee, in

its turn, undertook to carry out the developments within six months but time was not the essence of the contract. In the relevant accounting year the assessee actually received in cash only a sum of Rs. 29,392/- towards the sale price of the lands, but in accordance with the mercantile system of accounting adopted by it, it credited in its accounts the sum of Rs. 43,692 representing the full sale price of lands. At the same time, it also debited an estimated sum of Rs. 24,809/- as expenditure for the developments it had undertaken to carry out, even though no part of that amount was actually spent. The revenue had disallowed the expenditure. There it was held by the Supreme Court that the undertaking to carry out the developments within six months from the date of the deeds of sale (which, in view of the fact that time was not the essence of the contract, meant a reasonable time) was unconditional, the assessee binding itself to absolutely to carry out the same. That undertaking imported a liability on the assessee which accrued on dates of the deeds of sale, though that liability was to be discharged at a future date. It was thus an accrued liability and the estimated expenditure which would be incurred in discharging the same could be deducted from the profits and gains of the business, and the amount to be expended could be debited in accounts maintained in the mercantile

system of accounting before it was actually disbursed. The difficulty in the estimation therefore, did not, according to the Supreme Court, convert the accrued liability into a conditional one, because it was always open to the I.T. authorities concerned to arrive at a proper estimation thereof having regard to all the circumstances of the case. The Supreme Court further held that the sum of Rs.24,809 represented the estimated amount which would have to be expended by the assessee in the course of carrying on its business and was incidental to the business and, having regard to the accepted commercial practice and trading principles, was a deduction which, if there was no specific provision for it under section 10(2) of the Indian I.T. Act, 1922 was certainly an allowable deduction, in arriving at the profits and gains of the business of the assessee, under s.10(1) of the Act, there being no prohibition against it, express or implied, in the Act. It was further held by the Supreme Court that the expression "profits or gains" in s. 10(1) of the Indian I. T. Act, 1922, had to be understood in its commercial sense and there could be no computation of such profits and gains until the expenditure which was necessary for the purpose of earning the receipt was deducted therefrom- whether the expenditure was actually incurred or the liability in respect thereof had

accrued even though it might have to be discharged at some future date.

19. In the above view of the matter, we hold that the Tribunal was not justified in holding that no liability had accrued to the assessee under the Letter of Credit. In our view, the liability was very much incurred by the assessee though it was not discharged in view of legal dispute between the parties. So long as the dispute is not settled, said liability would continue to remain hanging over the head of the assessee as such assessee was entitled to claim deduction on account of this liability. In this view of the matter, the modified questions are answered in the negative i.e. in favour of the assessee and against the revenue.

(A.S. AGUIAR,J.) **(V.C. DAGA,J.)**